Financial market structure and development impact on investment

Unemployment is the result of shortage of demand on the goods market, and shortage of demand results particularly from a slow-down in investment. Therefore, when analysing why a market in capitalist economy does not necessarily achieve full employment equilibrium, policy makers should place investment at the centre stage of analysis.

From heterodox point of view, investment is dependent not only on the rate of interest, but also on expectations of future demand, and investment is treated as the main driver of economic growth process. Unlike classical approach to investment, in heterodox schools of thought, investment is pre-supposed to be independent from savings and availability of savings.

The structure of financial system (bank-based Vs market-based), government ownership of banks, and financial system reforms and/or interventions will have direct (positive or negative) effect on interest rate and volume of business investment (Chaiechi, et al 2006).

Accordingly an investment function in heterodox sense can be formulated as follows:

$$INVY = \alpha_0 + \alpha_1 MR + \alpha_2 QY + \alpha_3 R + \alpha_4 IR + \varepsilon$$

Where INVY is the ratio of Gross Capital formation over GDP, MR is monetisation ratio , and QY is the availability of Credit to businesses in the private sector, R is the business profit rate and IR is intrest rate which is the logarithm form of Deposit rate plus 1 divided by inflation rate plus 1.

The model presented above has a long line of ancestors: it goes back to Kalecki (1971) and Steindl (1952), and was reformulated by Rowthorn (1981) and Dutt (1984) and Blecker (1989). The version presented here is based on Marglin and Bhaduri (1990) which is a more general formulation of earlier neo-kaleckian models. It was then developed further by Onaran, O and Stockhammer, E. (2003), and Chaiechi (2006, and 2012).

Reference list

Blecker, R., 1989. “International Competition, Income Distribution and Economic Growth”, Cambridge Journal of Economics 13: 395-412

Chaiechi T, Mitchell, W.F, Juniper, J (2006) “Dynamic Investment and Financial Development, Application of Kaleckian, Post-Keynesian model”, *The Constraints to Full Employment or Work Choices and Welfare-to-Work, 8th Path to Full Employment Conference and 13th National Conference on Unemployment*, University of Newcastle

Chaiechi, T. (2012), “Financial development shocks and contemporaneous feedback effect on key macroeconomic indicators: A post-Keynesian time series analysis” *Economic Modelling*, Volume 29, Issue 2, March 2012, pp 487-501

Dutt, A. (1984), “Stagnation, income distribution and monopoly power”. CJE 8: 25-40

Kalecki, M. (1971), “Class, Struggle and the Distribution of National Income”, Kyklos, 24, pp. 1-8.

Steindl, J. (1952), Maturity and Stagnation in American Capitalism, Oxford, Basil Blackwell.

Prepared by Dr Taha Chaiechi, May 2018

Rowthorn, R, (1981), “Demand, real wages and economic growth”. Thames Papers in Political Economy. Autumn 1-39, reprinted in Studi Economici 1982, vol. 18 3-54 and also in Sawyer (ed): Post-Keynesian Economics

Onaran, O and Stockhammer, E. (2003),” *Accumulation, distribution and employment: A structural VAR approach to a Post Keynesian macro model”* Working pare series: Growth and employment in Europe, Working paper No.20 Vienna University of Economics and Business Administration

Prepared by Dr Taha Chaiechi, May 2018